VIEWPOINT

Northmarq

What Lies Ahead for Commercial Real Estate Lending:

A Conversation with Zalmi Klyne

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We recently caught up with Zalmi Klyne, Senior Vice President and Managing Director in Northmarq's Los Angeles, California office, to discuss challenges and opportunities that exist in today's commercial real estate (CRE) lending market, with a particular focus on multifamily. Mr. Klyne has nine years of experience in the commercial real estate industry as well as in other businesses. His insights and advice have proven invaluable to our clients in and around the Los Angeles metro, and we're pleased to share part of the conversation below.

Earlier in the year, we saw several high-profile bank failures. How have the CRE debt markets responded since then?

The response by regional banks has been fairly dramatic. Some have halted CRE lending in California altogether. Twelve months ago, we had perhaps 10 to 12 banks aggressively marketing for multifamily loans; now, there are only a few of them left. All the regionals have tightened standards. They almost all require a depository relationship before they will consider making a loan. We're seeing banks ask for deposits of between 10 and 20 percent of the loan value, and some are only lending to established, long-term customers. Their focus is on liquidity. Life insurance companies, however, are taking a different approach. They've become quite creative in developing flexible prepay structures and unique loan terms in order to attract and win high-quality business.

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> **Zalmi Klyne**
> **SVP, Managing Director**

What is your primary challenge in securing loan approvals for your clients in today's market?

Without a doubt, it's been the volatility in interest rates. When we're trying to price a loan for a developer or investor, and the Treasury market moves 35 or 40 basis points, it changes the metrics of the entire deal. The Fed is indicating perhaps one more rate hike this year, but coming to an understanding of where this market should be priced is a difficult and time-consuming task. And there's always the question of when will rates stop going up and start coming down.

You mentioned multifamily a moment ago – are there some subsets of the multifamily sector that are performing better than others? If so, why do you think that is?

Today's high mortgage rates have driven up the cost of homeownership and have frankly put it out of reach for many middle-class households. This is a big contributing factor in the support we're seeing for rental demand, especially in Class B and C apartments, which offer more stable and predictable rent growth than Class A properties. We've also seen impressive growth in manufactured housing community (MHC) properties over the last few years. There's a big appetite for MHC.

Are there any emerging trends you're keeping an eye on in today's market?

The work-from-home trend that's taken hold since the COVID-19 pandemic has created a very timely opportunity for office-to-multifamily conversions. That sector is gaining a lot of traction. Here in California, the accessory dwelling unit (ADU) law allows multifamily owners and developers to add up to 25 percent additional units and offers them an expedited approval process. Office-to-multifamily is not always feasible, but when it is, the opportunity can be great. I'd encourage office owners to read the following whitepaper recently authored by one of my colleagues for more information about this growing trend.

Can you share any predictions about the state of CRE lending over the next 12 to 18 months?

I'm pretty confident in predicting that rates will continue to stay high for a while. I'm not sure we'll see more rate hikes though – maybe just one more? Then, toward the end of the first quarter of 2024, I think rates could start to trend down. Once this market offers some stability and direction, it will help buyers and sellers, as well as banks and lenders, adjust their business plans. At that point, I think we'll see more deal volume.

Funding Available Despite Market Instability

As Mr. Klyne highlighted, the commercial and multifamily industries are poised to encounter ongoing challenges, with a volatile interest rate environment being a prominent influence in the immediate future. Nevertheless, challenges often pave the way for opportunities, and lending institutions remain active even in today's environment.

There are promising trends we're following, such as strong rental demand in Class B and C apartments due to high mortgage rates making homeownership less affordable for many middle-class households. Additionally, the growing interest in manufactured housing communities, as well as the opportunity for office-to-multifamily conversions driven by the work-from-home trend are noteworthy.

Looking ahead, interest rates are expected to remain high for some time before potentially trending down in early 2024, which would bring welcomed stability to the market and also lead to increasing deal volume over time.

For more information please contact:

Zalmi Klyne | *Senior Vice President, Managing Director*
zklyne@northmarq.com | (424) 422-0903

Kathy Locke | *Regional Marketing Manager*
klocke@northmarq.com | (952) 356-0100

Lanie Beck | *Senior Director, Content and Marketing Research*
lbeck@northmarq.com | (918) 494-2690

Northmarq

3500 American Blvd W
Suite 500
Minneapolis, MN 55431
(952) 356-0100
www.northmarq.com